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STEPTOE & JOHNSON LLP

ATTORNEYS AT LAW

Alfred M. Mamlet
202.429.6205
amamlet@steptoe.com

Maury Shenk
+44.20.7367.8092
mshenk@steptoe.com

ORIGINAL

1330 Connecticut Avenue, NW
Washington, DC 20036-1795

Telephone 202.429.3000
Facsimile 202.429.3902
www.steptoe.com



Marlene H. Dortch
Secretary
Federal Communications Commission
445 12th Street, S.W.
Washington, D.C. 20554

Re: Lockheed Martin Corporation and INTELSAT, Ltd., IB Docket No. 02-87

Dear Ms. Dortch:

On behalf of Sprint Communications Company L.P. ("Sprint") and WorldCom, Inc. ("WorldCom"), we respectfully submit this letter in the above-captioned proceeding. A copy has been served on all parties to this proceeding. In the June 7, 2002 Opposition of Lockheed Martin Corporation, Comsat Corporation, Comsat Digital Teleport, Inc. and Intelsat, Ltd., Intelsat (Bermuda) Ltd., Intelsat LLC, and Intelsat (collectively, "Comsat/Intelsat") to the Petition to Condition Grant filed by Sprint and WorldCom in the above-captioned matter, Comsat/Intelsat devoted substantial effort to convince the Commission that the Sprint/WorldCom and similar petitions raised only "commercial matters that have no bearing on the proposed transaction" and that Sprint/WorldCom essentially filed their petition for unworthy reasons. Comsat/Intelsat Opposition at 10. The Commission should ignore Comsat/Intelsat's baseless attacks, and focus on the important issues raised by Sprint/WorldCom.

Sprint and WorldCom respond first to Comsat/Intelsat's claim that the Sprint/WorldCom petition rests on "contrived claims concerning the structure of the marketplace" and that there is no relevant market for "U.S. wholesale Intelsat services. *Id.* As Sprint stated in its March 1, 2002 comments in CC Docket No. 01-337, it is textbook economics that a "market" is a set of buyers and sellers whose activities have an effect on the price of a product or service. In the case of telecommunications services, if one service is generally considered a substitute for another, then the two services could be said to operate in the same market.[1]

Commission precedent agrees. In its Second Report and Order in CC Docket No. 96-149, 12 FCC Rcd 15756 (1997), *recon.* 12 FCC Rcd 8730 (1997), *further recon.* 14 FCC Rcd

[1] Comments at 3 citing Baumol and Blinder, *Economics*, Harcourt Brace Jovanovich, 1979.

10771 (1999) ("Second Report"), the Commission decided that the 1992 Merger Guidelines of the Justice Department and the Federal Trade Commission[2] are suitable tools for analyzing telecommunications markets because they are "broadly drawn to accommodate virtually all marketplace characteristics," 12 FCC Rcd at 15773, including the market for certain international telecommunications services. *Id.* at 15787. In accordance with the Merger Guidelines, the Commission in the Second Report decided that its product market definitions should be based solely on demand substitutability considerations. 12 FCC Rcd at 15782. Demand substitutability identifies all of the products or services that consumers view as substitutes for each other, in response to changes in price. *Id.* at n. 120. Under the Merger Guidelines, U.S. wholesale Intelsat service is a distinct product market if a hypothetical profit maximizing firm that was the only present and future seller of those products likely would impose at least a small but significant and non-transitory increase in price. *Id.* at n. 119.

Judged against these standards, the product market for satellite services is not so broad as Comsat/Intelsat would have the Commission believe. Comsat/Intelsat would have the Commission believe that "vibrant commercial satellite and submarine cable enterprises" are in the same product market as Comsat/Intelsat's offerings.[3] As Sprint and WorldCom have previously informed the Commission, while commercial satellite providers and submarine cables can be adequate supply substitutes for Comsat/Intelsat service, too often that is not the case. Numerous historical and technical factors prevent submarine cable systems and commercial satellite providers from exercising effective competitive discipline over Comsat/Intelsat.

U.S. carriers like Sprint and WorldCom require end-to-end connectivity with foreign countries and often do not deal directly with customers in foreign countries, particularly for voice telephony services provided over satellite. Foreign-end satellite connectivity has traditionally been obtained through bilateral arrangements with foreign correspondents, which is still the most common way of doing business. These correspondents are totally responsible for the foreign end of the satellite circuit, and in many cases are monopolistic government post, telephone and telegraph (PTT) administrations with a financial interest in Intelsat.

There are still numerous countries where Intelsat is the only practical way to communicate directly with the U.S., including many countries that are not "thin routes" served exclusively by satellite. As Sprint and WorldCom pointed out[4] and as the Commission has previously recognized, no other satellite system can match Intelsat's reach to over 1000 earth stations around the world and coverage of 99 percent of the

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[2] 4 Trade Reg. Rep. (CCH) para. 13,104 at 20,569.

[3] The fact that the Federal Trade Commission terminated its review of the proposed transaction early should not influence the Commission's evaluation of the instant applications as Comsat/Intelsat have argued at pages 11 and 12 of their Opposition. As the Department informed the Commission at page 18, n.10 of its August 30, 1996 Reply Comments in CC Docket Nos. 96-149/96-61, the different objectives of regulation and antitrust enforcement may affect the application of the market definition in those contexts.

[4] Sprint/WorldCom Petition at 11.

globe.[5] In Sprint's and WorldCom's experience, most of central Asia and central Africa are, for all practical purposes, reachable only by Intelsat from the U.S. Bangladesh and Paraguay, for example, are not reached by any submarine cable systems and the PTTs in those countries, to the best of Sprint's and WorldCom's knowledge, utilize only Intelsat for direct communications with the U.S.[6]

Another very important example is China. Despite China's rapid telecommunications development over the past few years, China Telecom refused Sprint's request to replace satellite circuits into the vast interior of China with terrestrial circuits.[7] Furthermore, in attempting to transit traffic over terrestrial circuits in certain parts of the world, Sprint has found such alternate routing to be unsatisfactory because of questionable capacity, reliability and quality and high cost. Stated otherwise, there are compelling reasons why Sprint and WorldCom must use Comsat or Intelsat in a wide variety of circumstances.

Moreover, submarine cable systems linking many countries are not internally restorable. When such cables fail, communications via that undersea cable ceases for however long it takes to repair the failure or until ad hoc "best efforts" attempts to restore the cable succeed. Approximately two years ago, it took two to three weeks to repair an outage in the Pan American cable system, which was the only submarine cable serving Ecuador. During this lengthy period, carriers such as Sprint and WorldCom were only able to maintain limited direct telephone service from the U.S. to Ecuador by using Intelsat, to the best of our knowledge the only international satellite system employed by the government-owned Ecuadoran monopolists Andinatel and Pacifictel (the latter also being, according to Intelsat's July 24, 2002 letter to the Commission, an Intelsat shareholder). The SEA-ME-WE-3 and FLAG Europe Asia systems that serve much of Asia are other examples of important cable systems that are not internally restorable. Similarly, only ad hoc restoration is possible with the Antillas-1 and Bahamas-2 cables.

Furthermore, many end users such as government offices, call centers, financial institutions, and multinational corporations cannot afford to be disconnected for even a short period of time. These heavy communications users require diverse communications paths, which means satellite in countries where terrestrial infrastructure is still developing or where multiple submarine cables are unavailable. The U.S. Embassy in New Delhi, India is a typical end-user whose critical communications requirements underscore the need for routing diversity. Because the Embassy cannot risk the failure of its communications network, connectivity is maintained by both terrestrial and satellite

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[5] Intelsat evidently agrees, as in its 2001 Annual Report at page 2, it described its orbital locations as "prime beachfront property in the sky."

[6] While the Bangladesh Telecommunications Regulatory Commission has authorized VSAT licenses for use by Internet Service Providers, VSATs are today not a substitute for traditional Intelsat services to Bangladesh from the U.S.

[7] Sprint and WorldCom note that China Telecom (CT) may have refused to turn down Intelsat satellite circuits because CT had its own long-term contract with Intelsat, making it uneconomic for CT to cease using Intelsat. Unfortunately, CT's decision and position as a monopoly incumbent carrier in China effectively requires Sprint and WorldCom to use Intelsat as well.

media. For the U.S. Embassy in India and other heavy users doing business in India, Intelsat's service is not a substitute for submarine cables.[8]

Finally, Comsat/Intelsat does not face significant competition for its core services from competing satellite systems. This conclusion is confirmed by independent entities such as the World Bank Information for Development Program ("InfoDev"). The extensive InfoDev Briefing Report on Cable and Satellite Projects from the 1998 Conference on Global Connectivity for Africa in Addis Ababa concluded that "[f]ew private satellite systems have been successfully established, because the treaty organizations such as Intelsat have a monopoly of public services. Businesses like PanAmSat therefore focus on niche markets such as broadcasting and corporate networks."[9] The InfoDev Report also said that "for land-locked countries, or for countries with too small a demand to justify a cable landing point, the costs of connecting to a cable may offset entirely the initial cost advantage. For these countries, satellite systems may continue to be the preferred transmission option."[10]

In addition to wanting to protect their investment stake in Intelsat, foreign administrations have other substantial economic and technical reasons to deny U.S. carriers the right to use alternative satellite systems to exchange traffic. Because their earth stations are pointed to Intelsat space stations with provisioning and engineering conducted in accordance with well-established Intelsat standards and procedures, there are significant switching costs associated with using another satellite. In Sprint's and WorldCom's experience, it takes approximately a week to merely re-point an existing earth station from one Intelsat satellite to another Intelsat satellite, in large part because of the extensive testing and coordination that are required.

The difficulties are multiplied when a foreign carrier has only one earth station pointed towards Intelsat at a particular location. This is because existing traffic must be maintained at the same time that the antenna is re-pointed and the new circuits tested. To temporarily relocate existing services, install, test and return the services to the antenna takes approximately a month. Switching from an Intelsat satellite to a non-Intelsat satellite presents further challenges. Because Intelsat satellites utilize circular polarization while other suppliers often use linear polarization, switching from an Intelsat C-band satellite to a non-Intelsat C-band satellite could require a new antenna feed requiring a month to install.

In sum, there can be no doubt that U.S. wholesale Intelsat service is a distinct and relevant market or sub-market.

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[8] Intelsat agrees. At page 5 of its 1999 Annual Report, Intelsat said that "While we recognize the threat from fiber-optic cables on certain international routes, our digital telephony solutions are increasingly complementary to cable and remain attractive to major telecom companies."

[9] *See* http://www.infodev.org/projects/internet/220bmp/gca_e.pdf, at 7.

[10] *Id.* at 10.

Once a market has been defined, the Commission examines supply substitutability to determine whether a carrier has market power in a particular market. 12 FCC Rcd at 15775. In many countries, the supply of telecommunications services that compete with the Intelsat services of the national monopolist is actually illegal. In Cuba, for example, due to actions by ETECSA, the Cuban telecommunications monopolist, the submarine cable circuits extending between Cuba and the U.S. are no longer used to exchange telephone traffic. ETECSA unilaterally decided some time ago to cease exchanging all international telephone traffic directly with the United States. Direct connection between the U.S. and Cuba (aside from Guantanamo Bay) now exists only via Comsat and Intelsat. In Paraguay, ANTELCO, the state run telephone company, has shut down and seized the equipment of companies alleged to have been offering call-back service.[11] Panama has also seized the equipment of alleged illegal operators in the past, as has Cable and Wireless Jamaica.

In the vast majority of countries, the Intelsat shareholder also is the dominant domestic carrier, with the greatest (and perhaps the only) domestic footprint. Even where competition is permitted, it is often impossible for Intelsat's strongest competitors to enter and compete with Comsat/Intelsat for the provision of end-to-end service. In China and India, for example, stringent restrictions on foreign ownership of telecommunications providers prevent carriers like PanAmSat or New Skies from entering those markets without a controlling local partner. Moreover, telecommunications competition in those countries is in its infancy, with the Chinese and Indian governments remaining large shareholders of the incumbent telecommunications providers. The Indian government, for example, only allowed international competition in April 2002; retains a 26% ownership interest in Videsh Sanchar Nigam Limited (VSNL), the incumbent international provider; and owns the largest incumbent local provider, Bharat Sanchar Nigam Limited, outright. New Chinese regulations that take effect on October 1, 2002 stipulate that only "wholly state-owned telecommunications providers may operate international gateway facilities."[12]

Recognition of U.S. wholesale Intelsat service as a relevant market has important consequences for the U.S. public interest. A merger between Comsat and Intelsat would eliminate even the limited competition that currently exists between Comsat and Intelsat. Because Comsat is a minority investor in Intelsat, its interests are not directly aligned with those of Intelsat. Thus, after passage of the ORBIT Act and implementation of Level III direct access to Intelsat by the Commission, U.S. customers for the first time could access Intelsat directly from the U.S. without going through Comsat. As long as Comsat stood to lose business to Intelsat and was committed to utilize the space segment capacity in its contracts with that organization, Comsat had an economic incentive to compete with Intelsat. As pointed out by WorldCom, the availability of direct access did impose limited discipline on Comsat.[13]

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[11] *See* http://www.ustr.gov/html/2001_paraguay.pdf.

[12] "International Communications Gateway Facilities," CO2153005, "The Measures for Administration of International Gateway Facilities," htttp://www.chinalegalexchange.com/Archiv02/CO213006.html.

[13] Sprint/WorldCom Petition at 8.

If the proposed transaction is completed, however, this "will result in immediate termination of the existing capacity agreements between Intelsat and Comsat for capacity not already sold by Comsat."[14] Comsat will then become a mere distribution channel for Intelsat with no reason to undercut Intelsat's pricing. Freed from even limited competition by Comsat, Intelsat will undoubtedly accelerate its existing discriminatory practices which currently include promotional pricing to large customers at prices as much as 30 percent below the Intelsat Utilization Charge.[15] Very recently, Intelsat has also instituted another discount program called "Intelsat Rewards" which also offers substantial savings.

Without Comsat as a competitor and with the ability to operate as an unregulated private carrier, Intelsat will attain complete pricing freedom. It can sell a circuit as a private carrier on an unregulated basis if it wishes to offer prices close to marginal cost for a large customer that might build its own submarine cable, particularly a cable that did not threaten Comsat/Intelsat's core voice business.[16] It can also establish a much higher tariffed rate through a separate distribution channel for other customers whose demand is less price elastic. It will continue to sell capacity to Sprint and WorldCom at contractual rates. The ability of Comsat/Intelsat to engage in such price discrimination exists only because they possess significant market power in the relevant market.

The Commission has long been concerned that price discrimination can be used by a provider of bottleneck facilities to favor affiliated firms participating in downstream markets, or their own service offerings that integrate upstream or downstream components, over their competitors.[17] This discrimination will have long term, detrimental effects on competition in the downstream markets. It is this ability to distort the market structure and the long term performance of firms in the market that is the basis for Sprint's and WorldCom's concerns. Comsat/Intelsat, which will maintain bottleneck control over wholesale Intelsat capacity, will be in a position to favor its affiliates offering retail services in competition to U.S. carriers such as Sprint and WorldCom. This discrimination would lead to adverse effects in the retail markets served. For

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[14] Comsat/Intelsat Opposition at 7-8.

[15] Sprint/WorldCom Petition at 6. Comsat/Intelsat did not dispute this statement.

[16] This possibility is not hypothetical. In India, for example, until very recently ISPs were not permitted to use the services of VSNL, who monopolized all submarine cable capacity that reached India. Some ISPs installed their own satellite earth stations to obtain internet connectivity. Undoubtedly because transmission of IP protocol over satellite is not as efficient as using terrestrial circuits and raises a host of technical issues, one ISP, Bharti, formed a joint venture with Singapore Telecom to build the i2i submarine cable between Singapore and Chennai at great expense.

[17] Intelsat has explicitly stated its intention to compete in the provision of end-to-end service to customers. On its website, Intelsat says it is "expanding its satellite network to create a hybrid infrastructure comprising space and terrestrial elements. This hybrid infrastructure will enable us to deliver connectivity to major exchange points together with customized end-to-end solutions." *See* http:www.intelsat.com/annualreport/2001/business/business.html.

example, Sprint and WorldCom fully anticipate that for those locations that can be effectively served only by Intelsat, Comsat/Intelsat will price their services to U.S. end user customers in a manner that prevents Sprint and WorldCom from competing with Comsat/Intelsat for these customers.

Comsat/Intelsat argue that Sprint and WorldCom are using the instant proceeding as a vehicle to abrogate their existing contracts with Comsat. This is untrue. Sprint and WorldCom have focused on appropriate conditions to remedy discrimination in provision of Intelsat services, both under existing contracts and going forward.

Sprint and WorldCom have in fact raised concerns regarding the discriminatory effect of certain terms of their existing contracts, and the increased discriminatory effect that would result from Comsat/Intelsat merger. However, Sprint and WorldCom are not seeking to walk away from those contracts, but rather to impose appropriate merger-related conditions on the contracts in order to eliminate discrimination. As Sprint and WorldCom noted[18] and as Comsat/Intelsat did not dispute, the D.C. Circuit has held that a Commission order requiring the merged entity to eliminate discrimination does not abrogate contracts. *Western Union International, Inc.* v. *FCC*, 568 F.2d 1020 (D.C. Cir. 1977), *cert. den.* 436 U.S. 944 (1978). Comsat/Intelsat have options to eliminate existing and future price discrimination: they could, for example, implement a single worldwide pricing structure that is not inconsistent with the contracts that U.S. carriers have. Alternatively, they could decide not to proceed with the instant transaction.

More broadly, Sprint and WorldCom are concerned regarding the competitive impact of the Comsat/Intelsat merger on *future* competition in the overall U.S. market for wholesale Intelsat service. For some time now, Sprint and WorldCom have been competitively disadvantaged by the ability of new entrants to obtain direct access to Intelsat at rates much lower than those contained in the legacy contracts. The complete merger of Comsat and Intelsat will only exacerbate this situation.[19]

The unfettered pricing freedom that this merger would afford Comsat/Intelsat and the resultant price discrimination should concern the Commission. As Comsat/Intelsat conceded to the Commission, it intends to assign existing Comsat common carrier contracts to Intelsat USA License Corp., while transferring the bulk of existing Comsat employees and handling most future Comsat business as private carrier traffic through Intelsat USA Sales Corp.[20] This artificial division of common carrier and private carrier business would present clear opportunities for discrimination. It would, for example, make eminent sense for Intelsat to offer favorable private carrier, off-tariff pricing to its embedded base of monopoly foreign carriers in order to persuade them to remain with Intelsat. Once these carriers are firmly tied to Intelsat, Intelsat could easily leverage this

[18] Sprint/WorldCom Petition at 12.

[19] Indeed, it is telling that three of Comsat's largest customers, Sprint, WorldCom, and AT&T, have come forward in this proceeding to express concern about Comsat's current business practices, and the likely further negative effects of the Comsat/Intelsat transaction on the market in the future.

[20] Letter from Wiley, Rein & Fielding to International Bureau, at 3 (July 24, 2002).

monopoly by charging Sprint and WorldCom inflated prices to communicate with those foreign carriers via satellite, for there would be no alternative.

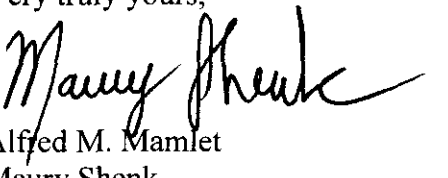
For this reason, Sprint and WorldCom have asked the Commission to condition the instant acquisition on a requirement that the merged entity offer U.S. customers "the same services at the same prices as it offers to other customers around the world."[21]

The Commission should also recognize that discrimination can occur in many different ways. If a WorldCom or Sprint circuit to Pakistan is no longer covered by a contract with Comsat, nothing would prevent Comsat/Intelsat from offering a replacement circuit at the same price on a different satellite that would require substantial expense for the Pakistan Telecommunications Company Limited (PTCL) to utilize. If Sprint or WorldCom sought to use the original circuit that was already used by PTCL, it might well be available only at a higher price on an unregulated, private carrier basis. It is for this reason that Sprint and WorldCom emphasized the importance of continuing to make the identical circuit available after any contracts have expired.

Alternatively, Intelsat might modify the terms of service to discriminate in ways other than price but with similar economic effect. For example, Intelsat is now offering contracts styled as "Gold" and "Platinum." Gold offers a lower price, but is a dedicated point-to-point service that cannot be changed to another point. Platinum costs more, but can be changed from its initial points of service to others (the original service terms and price continue to apply). Or the replacement service might only be available to Sprint or WorldCom on a satellite that would force either carrier to incur additional charges from others (a new third party earth station or access supplier) or even to incur the cost of building a new earth station, which would probably make it uneconomic to provide the requested service.

In conclusion, the proposed Comsat/Intelsat merger transaction carries risks for the public interest. Sprint and WorldCom urge the Commission to impose appropriate conditions on the transaction (as proposed in the Sprint/WorldCom petition) to remedy the clear risks of discrimination and reduced competition that would result from the merger.

Very truly yours,



Alfred M. Mamlet
Maury Shenk

*Counsel for Sprint Communications Company, L.P. and WorldCom, Inc.*

[21] Sprint/WorldCom Petition at 12.

## CERTIFICATE OF SERVICE

I, Todd B. Lantor, hereby certify that the foregoing letter has been served this 23rd day of August 2002, via first-class U.S. mail, postage prepaid, or via courier (indicated by *), upon the following persons:

William L. Whitely
Trustee
Litigation Recovery Trust
515 Madison Avenue
Suite 2306
New York, NY 10022-5402

Keith H. Fagan
Robert A. Mansbach
Lockheed Martin Global
Telecommunications
6560 Rock Spring Drive
Bethesda, MD 20817

Larry W. Secrest, III
Rosemary C. Harold
Wiley, Rein & Fielding
1776 K Street, N.W.
Washington, DC 20006

Gerald Musarra
Jennifer A. Warren
Lockheed Martin Corporation
1725 Jefferson Davis Hwy., Suite 403
Arlington, VA 22202

David B. Meltzer
Susan H. Crandall
Intelsat Global Service Corporation
3400 International Drive, N.W.
Washington, DC 20008

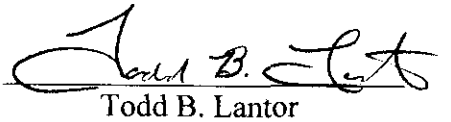
Jane E. Mago*
General Counsel
Office of General Counsel
Federal Communications Commission
445 12th Street, S.W.
Washington, DC 20554

Mark C. Rosenblum
Lawrence J. Lafaro
James J. R. Talbot
AT&T Corporation
Room 1121M1
2195 N. Maple Ave.
Basking Ridge, NJ 07920

James L. Ball*
Chief
Policy Division
International Bureau
Federal Communications Commission
445 12th Street, S.W.
Washington, DC 20554

Scott H. Lyon
Assistant General Counsel
Verestar, Inc.
3040 Williams Drive
Fairfax, VA 22031

Daniel J. Harrold*
Office of General Counsel
Federal Communications Commission
445 12th Street, S.W.
Washington, DC 20554



Todd B. Lantor